Prudential Securities

Food/Agribusiness Tobacco
Monthly Review

John M. McMillin, CFA
S. Leigh Ferst
Jane A. Shickich

Industry Rating: Buy

- Buy ADM, AMB, CPB, CPC, FLO, GEB, HRL, HSY, IBCC, IBP, MO, PHYB, RN, and UST.
- Company visit reviews with ADM, CPC, FLO, PHYB, OAT, SLE, UST, and UVV.

Research

June 2, 1992

Monthly Highlights:
Late Month Food Rally Propelled By Cereal Price Increase...3

Investment Opinion: Attractive Valuations Give Us Greater Optimism.....5

Company Visits:
Archer Daniels Midland: "Supermarketer To The World".....7
CPC International: Running Around The Globe.....11
Flowers Industries: Reaffirming Buy Rating.....15
Pioneer Hi-Bred International: The Beat Goes On.....18
Quaker Oats: Notes From Management Meeting.....20
Sara Lee Corporation: Review Of U.S. Foods Division.....23
UST, Inc.: Upbeat Analysts' Meeting.....28
Universal Corporation: Wait To Buy.....29

Quarterly Earnings Scorecard:
Above Expectations: HRL
Below Expectations: UVV
On Target: CPB, GEB.....33

Crop And Livestock Update: Broiler Prices Soar.....38

Agribusiness Margin Update:
Soybean And Beef Processing Margins Firm.....39

Earnings Revisions: Raised For HRL, OAT, PHYB, TYSNA
Lowered For CAG, CPB, GEB.....41

Earnings Models And Quarterly Projections.....45

Calendar Of Food And Tobacco Reporting Dates And Meetings.....76

2031660282

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 1. Food/Tobacco Industry

Fully Diluted Earnings Per Share

	Symbol	Price 5/29/92	Opinion	Fiscal Year 1990	Fiscal Year 1991	Fiscal Year 1992E	Fiscal Year 1993E	Calendar Year 1992E	Calendar Year 1993E	Est. 5-Year Growth	Calendarized P/E 1992E	Calendarized P/E 1993E	Yield
Packaged Food													
Borden, Inc.	BN	32	Hold	$2.46	$2.30 c	$2.45	$2.85	$2.45	$2.85	10 %	13.1	11.2	3.8 %
Campbell Soup Co.	CPB	34 1/4	Buy	1.18 c	1.58	1.92	2.20	2.08	2.35	14	16.5	14.6	2.3
CPC International	CPC	42 5/8	Buy	2.41	2.61 c	2.88	3.25	2.88	3.25	13	14.8	13.1	2.8
General Mills	GIS	63 1/2	Hold	2.27	2.66 c	3.05 c	3.50	3.30	3.75	13	19.2	16.9	2.3
Gerber Products Co.	GEB	63 7/8	Buy	2.84 c	3.40 c	3.85 Ac	4.35	4.23	4.75	12	15.1	13.4	2.3
Heinz, H.J.	HNZ	37 5/8	Hold	1.90	2.02 c	1.90 c	2.60	2.15	2.50	11	17.5	15.1	2.9
Hershey Foods Corp.	HSY	40 5/8	Buy	2.17 c	2.43	2.65	3.00	2.65	3.00	12	15.3	13.5	2.4
Kellogg Co.	K	58 1/2	Hold	2.12 c	2.51	2.88 c	3.30	2.88	3.30	15	20.3	17.7	1.9
Quaker Oats Co.	OAT	56 1/4	Hold	2.75 c	3.13 c	3.15	4.00	3.70	4.20	11	15.2	13.4	3.1
Ralston Purina Co.	RAL	46 3/8	Hold	3.13 c	3.36 c	3.35	3.75	3.40	3.80	11	13.6	12.2	2.6
Sara Lee Corp.	SLE	51	Hold	1.87	2.09	2.39 c	2.70	2.55	2.90	14	20.0	17.6	2.0
Wm. Wrigley Jr. Co.	WWY	71 3/4	Hold	2.99	3.28	3.65	4.10	3.65	4.10	12	19.7	17.5	2.3
Average										12.3 %	16.7	14.7	2.6 %
Agricultural/Small Cap.													
Archer Daniels Midland	ADM	25 3/4	Buy	$1.55	$1.49	$1.60	$1.90	$1.75	$2.02	14 %	14.7	12.7	0.4 %
Chiquita Brands Int'l+	CQB	18	Hold	2.20 c	2.52 c	0.80	2.00	0.80	2.00	12	22.5	9.0	3.8
ConAgra Inc.	CAG	25 3/4	Hold	1.25 c	1.41 c	1.53	1.75	1.62	1.85	12	15.9	13.9	2.1
Dean Foods Co.	DF	24 3/4	Hold	1.51	1.78	1.60	1.75	1.65	1.85	10	15.0	13.4	2.3
DEKALB Genetics**	SEEDB	30	Hold	2.55 c	2.70 c	2.25	2.75	2.30	2.80	10	13.0	10.7	2.7
Flowers Industries	FLO	16 5/8	Buy	0.97 c	0.71	0.90	1.15	1.10	1.25	12	15.1	13.3	4.3
GoodMark Foods**	GDMK	12 3/4	Hold	0.83	0.58 c	0.70	0.85	0.80	0.95	12	15.9	13.4	0.0
Hormel, Geo. A.	HRL	18 1/2	Buy	0.92 c	1.13	1.25	1.40	1.28	1.44	12	14.5	12.8	1.9
IBP, Inc.	IBP	18 1/4	Buy	1.01 c	0.03	1.35	1.75	1.35	1.75	12	13.5	10.4	1.1
Interstate Bakeries**+	IBC	15	Buy	0.55	1.19 c	1.40 c	1.50	1.40	1.55	11	10.7	9.7	2.9
McCormick & Co.**	MCCRK	24 1/2	Hold	0.76 c	0.98	1.15	1.32	1.17	1.35	14	21.0	18.1	1.5
Pioneer Hi-Bred Int'l**	PHYB	77	Buy	2.33 c	3.44	4.35	5.00	4.38	5.05	15	17.6	15.2	1.5
Tyson Foods Inc. **	TYSNA	18 5/8	Hold	0.90	1.05	1.15	1.25	1.17	1.28	10	15.9	14.6	0.2
Average										12.0 %	15.8	12.9	1.9 %
Tobacco													
American Brands	AMB	48	Buy	$3.50	$3.74	$4.20	$4.70	$4.20	$4.70	12 %	11.4	10.2	3.6 %
Philip Morris Cos.	MO !	77 1/2	Buy	3.83	4.54 c	5.50 c	6.65 c	5.50	6.65	20	14.1	11.7	2.7
RJR Nabisco	RN	10 1/4	Buy	(0.52)c	0.37	0.65	0.90	0.65	0.90	30	15.8	11.4	0.0
UST, Inc.	UST	29 3/4	Buy	0.97	1.17	1.40	1.65	1.40	1.65	18	21.3	18.0	2.7
Universal Corp.	UVV	25 3/4	Hold	1.41	1.72	2.10	2.40	2.27	2.40	14	11.3	10.7	3.1

c Excludes nonoperating items.
** Prudential Securities Inc. makes a primary over-the-counter market in the shares of this company.
+ Prudential Securities Inc. and/or its affiliates have managed or comanaged a public offering of securities and/or have performed investment banking or other services for this company.
! Single Best Idea.

Source: Prudential Securities.

2031660283

Prudential Securities

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

MONTHLY HIGHLIGHTS: LATE MONTH FOOD RALLY PROPELLED BY CEREAL PRICE INCREASES

After nearly five months of disinterest from investors focused on more cyclical issues, food stocks took off in late May, following a 3.5% cereal price increase by *Kellogg*. From our perspective, it was more the low relative valuations than the cereal price increase that caused the stocks to turn around. The move by Kellogg was simply the spark that lit the fire!

- ***Pioneer Hi-Bred* stock led the pack.** Table 2 shows the stocks that drove the May rebound. Most notable was the 22% gain by Pioneer Hi-Bred International, which we continue to recommend. (Note company visit later in the report.) Pioneer was aided by dry planting weather and signs of a sharp market-share gain. We believe investors also are beginning to perceive this company as more of an agricultural biotechnology stock, following the Food and Drug Administration's (FDA's) move to allow food products that use genetic crosses to get to the retail market earlier.

- **Commodity stocks had more mixed results.** *Tyson Foods* rebounded due to improving chicken prices. However, *Chiquita Brands* stayed in the tank by sinking another 12%. Year-to-date results show Chiquita shares down a whopping 55%. (See Table 3.) Over the last 12-months, Chiquita is off 60% (See Table 4).

- ***ConAgra's* stock did little in May, but its communications department was certainly busy.** In the most unusual press release we have seen in our decade as a food analyst, ConAgra said it "was recovering nicely from a case of corporate chuckles after reading *Campbell Soup Company's* May 15 misrepresentation of a soup suit decision" by the National Advertising Division of the Council of Better Business Bureaus. The fight is over ConAgra's entry into the ready-to-serve soup category and its use of comparative advertising.

We don't like to see food companies lobbing spitballs at each other. From our perspective, Healthy Choice expansion has united the food industry against it. Interestingly, the loser so far in soups seems to be Progresso, which is owned by *Pet, Inc.* (PT--15 3/4). Nonetheless, ConAgra doesn't appear to be winning much money in any of its Healthy Choice products, which makes its continued expansion (cheese, cold cuts) more difficult to understand.

Now we wonder whether ConAgra will go after Campbell in condensed soup where it holds a 90% share. ConAgra's efforts to fight Kraft in cheese, Oscar Mayer in cold cuts, and Campbell in condensed soups don't appear to us to be a recipe for success.

ConAgra also fought with *The Wall Street Journal* regarding its story on Healthy Choice competition. In a letter (dated May 13), to the managing editor that was also sent to analysts, ConAgra criticized the paper for not using its 12-week Information Resources shares and relying instead on 52-week Nielsen numbers.

2031660284

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

• **In more positive matters, share buyback plans accelerated last month, which may account for some of the stocks' improvement.** *Philip Morris* announced a whopping $3 billion authorization, which it hopes to complete in two years. If we add the $1.1 billion that it has remaining in its current authorization, Philip Morris is allocating $4 billion to support its stock. While this does not rule out another major food acquisition, it leaves us believing no big move is imminent. Everyone is waiting for the Supreme Court ruling on *Cipollone*, and these funds could be used to support the shares in the event of a negative tobacco ruling on preemption.

Gerber Products and *CPC* also announced new repurchase authorizations. *Borden* completed a 7-million share purchase, which it is using to a fund a zero-coupon convertible issue. We note that Borden's agent was able to acquire so many shares in only six weeks. Without the normal daily order to buy 250,000 shares, it is no wonder Borden's stock lagged the food group late last month.

Table 2. May Stock Price Performance

Packaged Food/ Tobacco	% Change 4/30/92	Agricultural/ Small Cap.	% Change 4/30/92
Quaker Oats Co.	7.6 %	Pioneer Hi-Bred	21.7 %
Sara Lee Corp.	6.5	Tyson Foods	19.2
Heinz, H.J.	3.4	McCormick & Co.	12.6
Kellogg Co.	3.3	IBP, inc.	6.6
RJR Nabisco	2.5	Archer Daniels-Midland	6.2
CPC International	0.9	DEKALB Genetics	3.4
Gerber Products	0.6	Dean Foods	3.1
Philip Morris Co.	-0.5	Flowers Industries	1.5
General Mills	-0.8	Hormel, Geo A.	1.4
Campbell Soup Co.	-1.1	ConAgra Inc.	0.5
Hershey Foods	-1.5	Universal Corp.	-1.0
Wm. Wrigley Jr. Co.	-1.5	American Brands	-1.3
Ralston Purina Co.	-3.6	GoodMark Foods	-1.9
Borden, Inc.	-5.5	UST Inc.	-2.1
	---	Interstate Bakeries	-4.0
		Chiquita Brands Int'l	-12.2

Average	0.7 %	Average	3.4 %
S&P Indus.	0.0 %	S&P Indus.	0.0 %
S&P 500	0.1	S&P 500	0.1

* Includes Fisher Price shares.

Table 3. Year-To-Date Stock Price Performance

Packaged Food/ Tobacco	% Change 12/31/91	Agricultural/ Small Cap.	% Change 12/31/91
Philip Morris Co.	-1.9 %	IBP, inc.	24.8 %
Borden, Inc.	-1.9	American Brands	6.7
Heinz, H.J.	-3.2	Pioneer Hi-Bred	3.7
RJR Nabisco	-5.7	DEKALB Genetics	3.4
CPC International	-5.8	Flowers Industries	2.3
Hershey Foods	-8.5	McCormick & Co.	-7.1
Kellogg Co.	-10.5	Tyson Foods	-7.5
Wm. Wrigley Jr. Co.	-11.1	UST Inc.	-9.2
Sara Lee Corp.	-11.9	GoodMark Foods	-12.1
General Mills	-13.8	Hormel, Geo A.	-13.5
Gerber Products	-16.5	Interstate Bakeries	-17.2
Ralston Purina Co.	-17.7	Dean Foods	-18.9
Campbell Soup Co.	-19.4	Archer Daniels-Midland	-22.5
Quaker Oats Co.	-22.1	Universal Corp.	-24.3
	---	ConAgra Inc.	-27.5
		Chiquita Brands Int'l	-55.0

Average	-10.7 %	Average	-10.9 %
S&P Indus.	-0.1 %	S&P Indus.	-0.1 %
S&P 500	-0.4	S&P 500	-0.4

* Includes Fisher Price shares.

2031660285

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 4. 12-Month Stock Price Performance

Packaged Food/ Tobacco	% Change 5/31/91	Agricultural/ Small Cap.	% Change 5/31/91
Sara Lee Corp.	26.3 %	Universal Corp.	54.9 %
Kellogg Co.	19.1	Pioneer Hi-Bred	46.0
Wm. Wrigley Jr. Co	13.4	GoodMark Foods	37.8
Philip Morris Co.	13.3	McCormick & Co.	31.5
Quaker Oats Co.	9.1	UST Inc.	30.1
General Mills	7.9	Archer Daniels-Midland	20.8
Gerber Products	-0.2	American Brands	12.9
Heinz, H.J.	-1.3	Flowers Industries	11.8
CPC International	-4.2	IBP, inc.	-1.4
RJR Nabisco	-6.8	Hormel, Geo A.	-6.3
Hershey Foods	-7.4	Tyson Foods	-15.3
Campbell Soup Co.	-11.9	ConAgra Inc.	-15.6
Ralston Purina Co.	-14.3	DEKALB Genetics	-17.8
Borden, Inc.	-16.6	Dean Foods	-20.5
		Chiquita Brands Int'l	-60.1
Average	1.9 %	Average	7.3 %
S&P Indus.	5.9 %	S&P Indus.	5.9 %
S&P 500	6.5	S&P 500	6.5

* Includes Fisher Price shares.

INVESTMENT OPINION: ATTRACTIVE VALUATIONS GIVE US GREATER OPTIMISM

Make no mistake about it, the domestic food industry environment is still difficult. Deep-pocketed competitors continue to battle one another with excessive promotions aimed at value-oriented consumers. A changing retail distribution system is also putting additional pressures on manufacturers to serve these new warehouse clubs without alienating traditional supermarket customers. Private-label products are also making inroads in both food and tobacco categories, reflecting better product quality and a value-oriented consumer base.

Despite an adverse climate, we have warmed up to some food and tobacco stocks in recent months due to more attractive valuations. American Brands, CPC International, Campbell Soup, Gerber Products, Geo. A. Hormel, and UST are all recent additions to our recommended list. Times may be tough, but when discounts to the market hit 20% we believe more optimism is warranted.

Our Buy rating on the food and tobacco companies is not the pound the table type recommendation we have issued in the past. Selectivity is still warranted, as seen by our 16 Hold ratings. But with no Sell ratings and with 14 Buy ratings, we are convinced that a Hold rating would be too negative for our current position. A moderate growth environment with low inflation should lead to modest outperformance for food and tobacco stocks.

Using a consensus profit forecast of 28.50 for 1993 S&P Industrial earnings, the packaged food group is selling at a 15% discount to the market. Philip Morris (our Single Best Idea) is selling at a 32% discount despite the fact that the company has taken its hit from FAS 87 (pension accounting) while food companies and S&P Industrial estimates have not largely not been adjusted. Any impact from higher

2031660286

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

oil prices would also seem to hurt the economy more than the consumer staples.

Potential international growth is also a reason for optimism. *Kellogg, Sara Lee, CPC International, Archer Daniels Midland, Wrigley,* and *Philip Morris* all have unique opportunities to grow in new European, Asian, and Soviet markets. Closer to home, *Gerber Products, Campbell Soup, McCormick, Quaker Oats,* and *Tyson Foods* are targeting the expanding Mexican and Latin American market. Canada also offers more interesting growth potential now that trade barriers are being relaxed.

All together, we believe low-double-digit industry growth is still an achievable target. Looking at Table 5, food industry growth averaged 11% in the years 1989-1991. Our 1993 estimates may be aggressive if promotions accelerate, the U.S. dollar appreciates, and selling prices remain dormant. But food executives (notable at *Kraft General Foods, Borden, Heinz, Sara Lee,* and *CPC*) have been busy lowering costs in the last year, and we believe these efforts should pay dividends over the next 18 months.

Table 5. Calendarized Packaged Food Earnings Growth

	Calendar-Year Fully Diluted Earnings From Operations															
Packaged Food	1985	1986		1987		1988		1989		1990		1991		1992E		1993E	
Borden, Inc.	$1.19	$1.50	26.1%	$1.81	20.7%	$2.11	16.6%	$2.32	10.0%	$2.46	6.0%	$2.30	-6.5%	$2.45	6.5%	$2.85	16.3
Campbell Soup Co.	0.78	0.89	14.1%	0.97	9.0%	1.06	9.3%	1.12	5.7%	1.36	21.4%	1.73	27.2%	2.08	20.2%	2.35	13.0
CPC International	0.93	1.15	23.7%	1.40	21.7%	1.84	31.4%	2.11	14.7%	2.41	14.2%	2.61	8.3%	2.88	10.3%	3.25	12.8
General Mills	0.96	1.14	18.8%	1.55	36.0%	1.80	16.1%	2.11	17.2%	2.50	18.5%	2.90	16.0%	3.30	13.8%	3.75	13.6
Gerber Products Co.	1.35	0.95	-29.4%	1.22	28.6%	1.93	58.2%	2.62	35.8%	3.22	22.9%	3.68	14.3%	4.23	14.9%	4.75	12.3
Heinz, H.J.	1.04	1.16	11.5%	1.38	19.0%	1.60	15.9%	1.79	11.9%	2.04	14.0%	1.88	-7.8%	2.15	14.4%	2.50	16.3
Hershey Foods Corp.	1.28	1.42	10.9%	1.64	15.5%	1.78	8.5%	1.90	6.7%	2.17	14.2%	2.43	12.0%	2.65	9.1%	3.00	13.2
Kellogg Co.	1.14	1.34	17.5%	1.60	19.4%	1.95	21.9%	1.80	-7.7%	2.12	17.8%	2.51	18.4%	2.88	14.7%	3.30	14.6
Kraft, Inc. (now KGF)*	2.82	2.95	4.6%	3.60	22.0%	NM		NM		2,648		2,962	11.9%	3,280	10.7%	3,691	12.5
Pillsbury	2.16	2.25	4.2%	2.60	15.6%												
Quaker Oats Co.	1.90	2.18	14.7%	2.63	20.6%	3.55	35.0%	3.45	-2.8%	2.75	-20.3%	3.40	23.6%	3.70	8.8%	4.20	13.5
Ralston Purina Co.	1.56	1.90	21.8%	2.22	16.8%	2.82	27.0%	2.69	-4.6%	3.26	21.2%	3.33	2.1%	3.40	2.1%	3.80	11.8
Sara Lee Corp.	0.97	1.10	13.4%	1.31	19.1%	1.59	21.4%	1.77	11.3%	1.98	11.9%	2.25	13.6%	2.55	13.3%	2.90	13.7
Wm. Wrigley Jr. Co.	1.03	1.27	23.3%	1.68	32.3%	2.18	29.8%	2.70	23.9%	2.99	10.7%	3.28	9.7%	3.65	11.3%	4.10	12.3
			1986		1987		1988		1989		1990		1991		1992E		1993E
Industry Average Growth			12.5%		21.1%		24.3%		10.2%		12.7%		11.0%		11.6%		13.5

* Operating earnings used for KGF.

Source: Prudential Securities.

We should also add that Table 5 now includes *Kraft General Foods* (KGF), which has revenues in excess of $30 billion. Obviously, using operating earnings instead of earnings per share negates the benefit of free cash flow. However, KGF is just too big not to be included in packaged food, and acquisition growth from Jacobs Suchard adjusts for some of the unrecognized cash-flow benefits. We also added *Wrigley*, which we picked up coverage on last month. If *ConAgra* would better segment its prepared food group to exclude commodity poultry and red meat operations, we would look to add the company to our packaged food group as well.

2031660287

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

COMPANY VISITS:

Last month, we had a busy time visiting food and tobacco companies. In total, we wrote up eight company meetings with senior management.

ARCHER DANIELS MIDLAND CO. (ADM--25 3/4)--NYSE
SUPERMARKETER TO THE WORLD **Buy** (*Low Risk*)

	Earnings Per Share Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	6/91	6/92E	6/93E	1993E	Div.	Yield	(Mil.)	Range
New	$1.49	$1.60	$1.90	12.7X	$0.10	0.4%	313.4	33-22
Old								

Archer Daniels Midland's Chairman Dwayne O. Andreas addressed investors at the New York Society of Security Analysts (NYSSA) on May 28, 1992. Interestingly, two months earlier, Heinz Chairman Anthony J.F. O'Reilly stood on the same spot, leaving this food analyst with little choice but to compare the two executives' similarities and differences:

- **View of corn sweetener industry.** On March 31, 1992, Dr. O'Reilly stated that Heinz "sold Hubinger at an opportune moment, as those of you must know who have followed subsequent trends in the fructose market. During the past six months, corn prices rose 9% to 10% and fructose prices dropped 20%." Comparing fructose prices at the peak-demand summer season with those during the winter low-demand season makes little sense, and in our view, Dr. O'Reilly knows it. Certainly, Heinz exited its fructose subsidiary with a great price of $325 million, or 1.3 times revenues and 7.5 times operating earnings. But leaving investors with the idea that Heinz got out just in time is pure exaggeration, in our opinion.

While Mr. Andreas can also exaggerate with the best of executives and politicians, he gave a more factual presentation of the fructose market, where ADM earns approximately one third of its total earnings. Fructose prices for the important June quarter are comparable to year-earlier levels. Unit demand is running up a surprising 3% to 4% due, in part, to excellent demand for regular soft drinks. Although net corn costs are up modestly from year-ago levels, margins should be level as a result of greater plant efficiencies. "Overall, the corn division is coming along quite well," according to corn refining head Mr. Martin Andreas, and we agree.

- **Fame.** Both executives have garnered a great deal of media attention of late. In his first show, Jay Leno was talking about big salaries and mentioned "that guy at Heinz" in his opening monologue. Mr. Andreas was visited by Mikhail Gorbachev in his tour of the United States last month. Mr. Andreas also has a new book written about him called *Supermarketer To The World,* which we would recommend reading to understand how personal contacts have helped build the ADM network; this was discussed in detail at the NYSSA meeting.

2031660288

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

• **Compensation.** Both executives personally own about 5% of the outstanding shares of their companies, which in each case works to around $400 million. But we note that Mr. Andreas has not attained shares via restricted stock grants or stock options. We also note that Mr. Andreas recently purchased another $10 million worth of ADM stock with his own money. By comparison, Dr. O'Reilly has sold a sizable stake of Heinz in the last year, partly to pay taxes.

• **Advertising.** As he believes the three major television networks are losing share but raising rates, Dr. O'Reilly has significantly lowered media advertising in favor of coupons and promotions. Obviously, the Heinz executive has never checked the rates on Sunday morning shows like "Meet The Press" where ADM advertizes the value of ethanol every Sunday morning. These commercials bother some investors, who believe that political support is the backbone for ADM earnings.

Chairman Andreas explained at considerable length that governments control agriculture around the world. While a G.A.T.T. agreement would improve this situation, Mr. Andreas expressed skepticism that even a watered-down agreement could be reached anytime soon.

Being in agriculture requires dealing with governments. Towards this end, Mr. Andreas views ADM as a "public utility," providing necessary wheat flour, animal feed, and corn starch to countries around the world.

"We used to need the government's aid to do things, but now the government needs our aid because...ADM owns 30% of [U.S.] corn...wheat...and soybean capacity," stated Mr. Andreas. We should add that ADM still needs the government's aid (or the E.P.A.'s) to get a volatility waiver for ethanol for the reformulated fuels program that begins in 1995. But with the help of his assistant, Howard Buffett, Mr. Andreas left investors believing something would be worked out. As we stated in a detailed report on ADM dated May 1, 1992, we believe ethanol will receive credit for its lower carbon monoxide (CO) emissions to offset its higher volatility or vapor pressure.

• **Global perspective.** We have obviously gone after Dr. O'Reilly primarily because of what we believe are his unwarranted fructose comments. But we should note that the Heinz executive had a global perspective well before it became fashionable. Moreover, current investments in China, Zimbabwe, and other less developed areas get little attention because they should not contribute to earnings for many years. But the ventures should pay off handsomely for Heinz shareholders in the next century.

Chairman Andreas is also a man with a global vision. He is planting investment seeds in China, the Soviet Republics, and other areas that won't harvest anytime soon. More immediate are the expanding investments in Canada, Europe, and Mexico that were discussed in detail at the NYSSA meeting. In total, ADM has spent $1.3 billion (note Table 6) in acquisitions and capital spending in just the last

2031660289

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

18 months. The payoff from these investments may approach what Heinz has gotten from its United Kingdom position in the last few years. Both executives are truly supermarketers to the world.

• **Jokes.** No comparison would be complete without stating that both executives love to spin yarns. Dr. O'Reilly's stories may be funnier, but everyone in the investment community has heard them all a million times. Mr. Andreas tells new jokes with every appearance. Most deal with political leaders while Dr. O'Reilly loves to poke fun at the Queen of England. In ending his NYSSA presentation, Mr. Andreas joked "that Mr. [Ross] Perot by saying nothing gets more popular every day [while] Mr. Quayle by talking all the time gets less popular. So I'm sure if I talk too much my stock will go down".

Table 6. ADM Expenditures For Property, Plant, Equipment, And Acquisitions
(Dollar Amounts In Millions)

Year	Amount	Total Additions
1980	$194.50	
1981	370.5	
1982	163.3	
1983	147.7	
1984	150.5	
1985	160.4	
1986	341.9	
1987	314.7	
1988	370.3	
1989	405.9	$3,170.6 total for the 1980s
1990	550.9	
1991	862.7	
1992E	550.0	

Source: Archer Daniels Midland.

DROUGHT IS MAJOR NEAR-TERM RISK

We don't see ADM's stock going down unless crop problems develop over the next two months. Carryover supplies are low for both corn and soybeans, and processing plants may be underutilized unless a decent crop comes in. Thankfully, corn planting went without any problems (Note Pioneer Hi-Bred review later in this report.) Now all ADM investors can do is hope the seed grows tall and healthy.

Mr. Andreas doesn't mind a drought or two every decade. It allows the company to utilize its strong cash position to purchase depressed assets. Actually, the last few years since the 1988 drought have been mixed ones for grain merchandising and some grains processing assets. This more difficult climate has caused some industry consolidation, particularly in flour milling where ADM now has a North American share comparable to ConAgra's position (e.g., 30%).

As branded food companies like Unilever and Procter & Gamble sell their processing assets to ADM and as free-standing poorly

2031660290

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

capitalized family operations and cooperatives go into ADM's network, this consolidation trend is accelerating, according to Mr. Andreas. We should also note that ADM has teamed up with the Gardini Group in Italy, which will likely buy Quaker Oats's Cuore corn oil brand.

As far as near-term earnings prospects are concerned, we sat next to CFO Douglas Schmalz, who pointed out that LIFO (last in first out) inventory accounting makes the price of corn a fourth-quarter earnings variable. Lately, corn prices have been moving up, reflecting the weather uncertainty. Nonetheless, ethanol prices are firm since higher oil prices raise MTBE production costs. With soybean margins also firming, we feel confident with our $0.42 per share fourth-fiscal-quarter estimate versus $0.40 for the year-ago period. We also note that the recently released third-quarter income statement showed better-than-expected operating trends (Note Table 7.)

The reason to buy ADM is largely for a projected earnings acceleration beginning in the second quarter of fiscal 1993. At that point, the Clean Air Bill begins and payoffs from large bioproducts should start. Ironically, Heinz's earnings should also be accelerating at the same time due to easy comparisons and a payoff from heavy promotions. However, despite the uncertainties surrounding commodity businesses, we feel more comfortable buying ADM than Heinz because we believe the earnings acceleration could be more powerful and more sustaining. (Please note our May 1, 1992, ADM report for more details).

Table 7. ADM's Third-Fiscal-Quarter Income Statement Showed Surprisingly Strong Operating Growth
(Dollar Amounts In Millions)

	3/31/91	3/31/92	% Change
Net Sales	$2,092,949	$2,235,668	6.8%
Cost Of Products Sold	(1,880,002)	(1,996,709)	6.2%
Gross Profit	212,947	238,959	12.2%
S.G.& A.	(74,141)	(77,247)	4.2%
Operating Income	138,806	161,712	16.5%
Interest Expense	(24,218)	(28,362)	17.1%
Interest Income	20,439	17,199	-15.9%
Gain On Securities	24,839	32	-99.9%
Other	21,872	15,752	-28.0%
Pretax Income	181,738	166,333	-8.5%
Taxes	(63,645)	(57,248)	-10.1%
Tax Rate	35.0%	34.4%	-1.7%
Net Income	118,093	109,085	-7.6%
Earnings Per Share	$0.38	$0.35	-7.9%
Shares Outstanding	311.8	312.5	0.2%
Margins: Percent Of Sales			
Gross Profit	10.2%	10.7%	
Operating Income	6.6%	7.2%	
Pretax Income	8.7%	7.4%	
Net Income	5.6%	4.9%	

2031660291

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

CPC INTERNATIONAL (CPC--42 5/8) -- NYSE
RUNNING AROUND THE GLOBE **Buy** (*Low Risk*)

	Earnings Per Share Fiscal Year Ending			P/E	Ind.		Shares O/S	52-Week
	12/91	12/92E	12/93E	12/93E	Div.	Yield	(Mil.)	Range
New	$2.61	$2.88	$3.25	13.1X	$1.20	2.8%	151.4	47-39
Old								

We had lunch with Chairman Charles R. Shoemate on May 20, 1992, at CPC's headquarters in Englewood Cliffs, New Jersey. We left more confident about the resumption of double-digit earnings growth after more than a year of single-digit gains. While the stock has outperformed its peer group over the past three months since the Florida Food Conference, we still rate the shares Buy with a 12-month target price of $50.

A global portfolio of premium brands is the reason for our optimism. Domestic grocery conditions remain intensely competitive, but Latin American operations are picking up the slack. The core European business remains quite healthy, although weaker economies and difficult comparisons are temporarily reducing earnings growth. Asian activities again appear poised for 20% growth. For a more detailed run around the globe, we add the following based on our conversations with management.

- **Europe** (40% of total revenues) is faced with another difficult comparison in the second quarter, which ended in March 1992, because all international operations are reported on a three-month lag. Nonetheless, management believes an earnings gain is possible for Europe in the quarter, despite continued negative currency comparisons and a year-earlier quarter when the war caused hoarding by European consumers. Moreover, retail destocking is occurring in France where credit terms are being reduced by one month to conform with the European Community.

Weaker economies are also a factor behind slower European growth. However, Germany is the heart of CPC in Europe, and business conditions in the region remain excellent for the company. (Note Table 8.) With comparisons to the pipeline filling in East Germany now over, double-digit earnings growth in local currencies should resume. Mr. Shoemate reported that only in the United Kingdom is the environment more difficult. Italy and Switzerland are both doing well. Acquisitions, including Napolina pasta, Ambrosia desserts, Banania and Benco chocolate beverages, and Marmite yeast spread have added scale to Knorr, which has European revenues of just over $1.0 billion.

Opportunities also exist to enhance CPC's 11.8% operating margins in Europe. Last year the company noted that there were 31 factories in Europe; this year the number is down to 29. With a common market allowing cross border trade, manufacturing can obviously be further consolidated. However, Mr. Shoemate wouldn't let us get too

2031660292

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

optimistic with our margin-growth forecasts, noting that the Knorr product line ($1.3 billion in Europe) is highly diversified, which results in shorter production runs and higher unit costs. But Mr. Shoemate emphasized that with new product growth stimulating 5% plus unit gains for Knorr, product mix advances would still be achieved, thereby fueling more margin gains. New products for Knorr carry higher margins because of an absence of initial competition.

- **Latin America** (15% of revenues) is back on a growth track in 1992. Consumer food profits should be up in the 25% to 30% range, fueled by strong results in Argentina and Mexico. Brazil (40% of the regions' revenues) remains in a state of economic flux, but comparisons have become much easier. Moreover, margins are expanding throughout the Latin American region due to lower financing costs. Corn refining profits should be up 70% to 75% from a depressed base, which is actually a bit below management's initial expectations. But consumer food operations are substantially larger, and they are well ahead of plan. In total, Latin America should account for over 16% of CPC's profits in 1992.

- **Asian** operations (4% of revenues) are bigger than reported sales. Japanese operations were sold to Ajinomoto for a sizable $300 million five years ago, and CPC collects a large royalty from the sales. Nonetheless, Mr. Shoemate seemed to regret the move by his predecessor, Jim Eiszner, who seemed forced into the transaction by takeover pressures. The remaining Asian operations have rebounded after a flat 1991. Philippine earnings are up, and other areas remain firm. All together, management expects the region to begin generating 20% earnings growth, which is an ambitious but attainable goal, in our opinion. Unfortunately, the gains are off a relatively low base.

- **Canadian** activities (5% of revenues) include both corn refining and grocery operations. Operating margins of 16.3% show the strength of CPC's Canadian positions, particularly in peanut butter and mayonnaise. The acquisition of the Squirrel peanut butter brand helped 1991 earnings grow 27%. Interestingly, Canadian earnings have quietly grown at a 34% compound annual rate over the past three years. Long-term growth should not be as robust, but CPC's business north of the border appears capable of low double-digit growth.

- **Domestic corn refining** (estimated 10% of total revenues) is approximately a $650 million business with a market share between 11% and 12%, by our calculations. This position is only one third the size of industry giant Archer Daniels Midland, and investors often speculate that CPC will divest the business. H.J. Heinz received $340 million for its Hubinger subsidiary last summer, which controlled only 5% of the market. With increased consolidation in soft drink bottlers, the corn sweetener pricing environment may not be the cartel that it used to be. Nonetheless, business conditions remain stable, and ethanol offers new growth potential. Mr. Shoemate appeared content with the division and its free cash-flow generation. However, the days of earnings growing at a 20% compound annual rate appear to be over.

2031660293

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

• **Domestic grocery** (estimated 26% of revenues) operations are commonly called Best Foods, both inside and outside the company. In 1991, Best Foods suffered its worst year in our decade of following the company. Operating earnings fell 5% due to severe competition and a number of unusual events. With better peanut costs and the spread between corn oil and vegetable oil narrowing, Best Foods should resume earnings growth in 1992.

However, the severe competition that characterized 1991 is still around, as evidenced by our Memorial Day visit to Walbaum's on Long Island. With a label that said "if you like Hellmann's, try us", Walbaum's private-label real mayonnaise was featured at $0.99 per jar versus $2.47 for Hellmann's and $2.57 for Kraft. According to the store manager, the regular list price for the private-label mayonnaise is $1.47, which is still a 40% discount to Hellmann's.

Mr. Shoemate regarded the domestic recession as the root of Best Foods's problems. Frankly, this explanation bothered us a bit because we regard this value shopping movement as more of a secular trend. Nonetheless, Mr. Shoemate has a right to feel a bit smug, given Hellmann's 50% plus share and Kraft's apparent failure in fat free mayonnaise.

Management has also gotten more aggressive domestically with efforts to introduce new products (mustard, canola oil) and to leverage brands names. But with operating margins approximating 15% and with volumes remaining flat, Best Foods is going to have to struggle to sustain a growth rate much above 6% to 7%.

The acquisition of Fearn foodservice soup should aid 1992's growth, but more scale is needed in the Midwest where peanut butter and corn oil shares are lower.

Best Foods is a formidable franchise on the East and West Coasts. But it needs help in the heartland where all the new warehouse clubs seem to be being built. In total, Best Foods is an average packaged foods company that needs superior management to generate above average growth.

2031660294

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 8. CPC International At A Glance
(Dollar Amounts In Millions)

North American Grocery Products

Category	CPC Brands	Est. 1992 Revenues	% Est. Total Rev.	% Earnings	Market Share	Volume Growth 86	87	88	89	90	91
Mayonnaise	Hellmann's Best Foods	$375			51 %						
Specialty Baking	Arnold's	475			7						
	Thomas, Old London				39						
Foodservice	Hellman's, Fearn	400			--						
Peanut Butter	Skippy	190			20						
Cooking Oils	Mazola	175			16						
Pasta	Mueller's	150			12						
Other	Knorr Argo, Golden Griddle	110			--						
Canada	Hellman's, Squirrel, Bourll	200			--						
		$2,075	31 %	34 %		0	5	0	1	1	0
North American Corn Refining		$650	10 %	10 %		3	2	10	6	4	1
European Consumer											
Germany	Knorr, Mazola, Majala	650									
United Kingdom	Knorr, Marmite, Hellmann's	450									
France	Knorr, Benco, Alsa	375									
Italy	Knorr, Santa Rosa, Napolina	325									
Switzerland	Knorr	200									
Other	Knorr	685									
		$2,685	40 %	35 %		3	9	12	7	11	10
Latin America											
Consumer	Knorr, Maizena, Mazola	600	10 %	13 %		9	13	10	-2	4	5
Corn Refining		350	5 %	3 %		10	15	-2	-1	6	-3
		$950									
Asia	Best Foods, Knorr	$240	4 %	5 %		5	16	20	10	13	5
	[redacted]	$6,600	100 %	100 %		2	6	4	3	6	5

Source: Prudential Securities.

With no announced earnings growth goal to reach in 1992, Mr. Shoemate seemed more relaxed than a year-ago when the company had committed to double-digit growth. With currency rates turning more favorable, management, including CFO Konrad Schlatter, appeared confident of renewed double-digit earnings growth. Whether CPC can achieve this growth in the second quarter is still in doubt, but we left believing it was possible. If not, the third quarter should be turn in double-digit earnings momentum.

Mr. Shoemate has now been CPC's CEO for almost two years, and some changes within the company are becoming noticeable. First, CPC seems more flexible than in years past. Always a controlled company (note constant 40% tax rate) that seemed to be run by a management textbook, CPC now appears to have a greater sense of urgency and a management more open to change. Previously, management frowned on leveraging off the Hellmann's brand, but Mr. Shoemate has altered some management rules in efforts to grow. He also is stressing management quickness in seizing new markets like Eastern Europe and the Soviet Republics.

2031660295

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

With its global infrastructure, CPC appears capable of internal growth of at least 10%. Adding the strong free cash flow, which should be used to repurchase shares (note new 2 million authorization) and make acquisitions (particularly in Eastern Europe), earnings per share should compound at a 12% annual rate even if domestic operations grow at only a 7% rate. At the current multiple, the shares appear undervalued in light of this projected earnings acceleration.

FLOWERS INDUSTRIES (FLO--16 5/8) -- NYSE
REAFFIRMING BUY RATING **Buy** (*Low Risk*)

	Earnings Per Share Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	6/91	6/92E	6/93E	1993E	Div.	Yield	(Mil.)	Range
New	$0.71	$0.90	$1.15	13.2X	$0.71	4.3%	34.1	18-13
Old								

As is the case with Pioneer Hi-Bred, which we discuss in detail next in this Monthly Review, Flowers Industries is a quality, debt-adverse company with family members in key management positions. Both companies built enviable earnings records in the 1970s-to-middle 1980s, but they suffered hard times in the second half of the decade. Now both have emerged as stronger companies in the 1990s due largely to heavy spending programs implemented when times were tough.

CFO C. Martin (Marty) Wood III visited Boston analysts as our guest on May 6, 1992. Seeing how this spending is paying off, we left more confident in our earnings estimates for fiscal 1992 and 1993, and in our 12% long-term earnings growth rate for the Southeast's largest baker.

We also left feeling better about our Buy rating, despite the stock's sharp turnaround in the last six months. Flowers is not as powerful of a growth story as Pioneer Hi-Bred from our perspective, but FLO still looks modestly undervalued in light of its financial quality, strong dividend yield, and projected earnings acceleration.

2031660296

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 9. Flowers Industries At A Glance
(Dollar Amounts In Millions)

Category	Flowers Brands	Est. F'92 Rev.	Est. % Total Rev.	Est. % Total Profits	Volume Growth F'91	Est. F'92
Branded White Bread	Bunny, SunBeam, Tastee	$200	23 %	21 %	+3	+1
Wheat & Variety Bread	Nature's Own	125	14	18	+1	+2
Specialty Breads	Cobblestone Mill	70	8	11	+24	+5
Buns	Special Harvest	15	2	3	+5	+1
Rolls	Special Harvest	20	2	3	+4	+1
Private Label	Supermarket Brands	145	17	5	+6	0
Total Bread		$575	66 %	61 %	+4	+2
Snack Cakes	Beebo, Bluebird, Jubilee	110	13	15	0	−1
Frozen Baked Goods	Our Special Touch, Pies	80	9	6	+100	+100
Frozen Vegetables	Stilwell	110	12	18	+7	+10
		$875	100 %	100 %	+5	+3

Source: Prudential Securities.

Understanding What Went Wrong Helps To See The Things Now Going Right

Late last month, oil prices spiked up because of the moves by Saudi Arabia. At the same time, wheat prices advanced sharply owing to concern that cold weather would hurt the crop. Like any other baker with lots of delivery trucks, Flowers doesn't like gasoline costs going up. But the 32% advance in wheat costs in the last year hasn't been all bad news, considering that it has finally raised the cost of private-label bread, which competes against Flowers's branded products.

Flowers has some commodity aspects that many consumer- branded analysts shy away from. Mr. Wood began his Boston meetings by describing in detail how wheat prices got hedged incorrectly in 1989 and how the 1988 drought hurt both its bread and vegetable businesses. He also described how the company expanded in Texas in the 1980s just as lower oil prices were sending the economies of the region into a tailspin. He also described in detail how sharply lower wheat prices in fiscal 1991 helped accelerate the growth of private-label products in a weak southeast economy.

While higher gasoline and wheat prices are a concern, Flowers has most of the key variables now going its way. The southeast economy appears to be improving, sending more consumers back to Flowers's branded products. Vegetable prices are also beginning to firm, which should help expanded Stilwell operations. More importantly, price increases have been successfully implemented for bread products, and

2031660297

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

competition (primarily from Interstate Bakeries) has been less cutthroat.

Flowers has also emerged from its period of difficulty as a company more in control of its destiny. Mr. Wood talked at length about the opportunities to serve the $4.5 billion in-store deli bakery category. (Note Table 10.) As Table 9 shows, Flowers currently has nearly $200 million of frozen baked goods and vegetable sales. But with acquisitions and internal spending to put freezing capacity in its plants, Flowers could turn this division into a $400 million operation in five years, according to Mr. Wood. Using Stilwell frozen vegetable distribution, Flowers has exciting growth opportunities in frozen baked goods, which few analysts acknowledge.

Flowers also is stronger internally due to expensive efforts to automate plants and lower labor costs. Over one quarter of production is now in new generation bread plants that require less manual input. Inefficient plants (e.g., Fort Pierce, Florida) have been closed, and capacity utilization rates for the company have moved to over 80%.

Table 10. Bakery Market Segments
(In Billions)

Supermarket (Traditional)	14.0
Foodservice	6.5
In-Store Deli Bakery	4.5

Source: Flowers Industries.

Flowers is also stronger after spending to serve Winn-Dixie in North Carolina markets. Obviously, the program to provide Winn-Dixie with private-label products throughout its system has been more costly than analysts or even the company anticipated. Opening new routes and seeing the percentage of stale product returns rise can be a costly exercise. But now that North Carolina plant capacity has been added, the payoff is here.

We should also note that Flowers management regards the spinoff of Continental Baking Company (CBC) by Ralston Purina as a positive. An independent CBC might allow greater industry discipline and knowledge. Management's effort to combine CBC into Flowers's Human and Pet Food segment left competitors wondering what was going on. Now investors and competitors should see a large baker struggling to lower it costs despite higher union labor rates. The result may be plant closings and route withdrawals, which should help industry capacity utilization rates and bread prices. This indeed would be good news for competitive bakers.

2031660298

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

PIONEER HI-BRED INTERNATIONAL (PHYB--77) -- OTC
THE BEAT GOES ON **Buy** *(Low Risk)*

	Earnings Per Share Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	8/91	8/92E	8/93E	1993E	Div.	Yield	(Mil.)	Range
New	$3.44	$4.35	$5.00	15.2X	$1.16	1.5%	30.2	77-47
Old		3.90	4.60					

After a five-year period of difficulty, Pioneer Hi-Bred International is clearly on a roll. Earnings in fiscal 1991 (ending August) rose 47% despite sizable increases in both bad debt expense and inventory writedowns. Now fiscal 1992 results should be significantly above consensus expectations, according to a company press release.

We are raising our fiscal 1992 projection to 4.35 per share from $3.90, which was already on the high end of street expectations. The company release projected earnings above $4.00 per share, and management's new targeted range is in the $4.20 to $4.30 per share area. The achievement of these results in a year of higher production costs is noteworthy.

We reiterate our strong Buy rating, believing the beat will go into fiscal 1993 when production costs should moderate. Our new fiscal 1993 projection is $5.00 per share, up from $4.60.

The principal factor behind the positive surprise is in North America where corn acreage increases are being combined with strong share gains. Management now expects unit corn seed sales to rise between 8% and 10% in fiscal 1992 versus the expected 4% acreage increase.

Management Visits New York And Washington

CFO Jerry Chicoine visited New York and Washington analysts on May 18 and 19, 1992, respectively, to discuss these improved near-term prospects as well as the outlook for fiscal 1993 and beyond.

- **Near-term prospects.** Mr. Chicoine admitted that management's new targeted earnings range of $4.20 to $4.30 for fiscal 1992 has opportunities to move "North". At the time of the meeting, the soybean crop had yet to be fully planted, and this business contributes well over $0.25 per share to earnings. More importantly, Mr. Chicoine noted that the 8% to 10% gain for North American corn seed shipments could have upside potential. Putting these two factors together, our $4.35 per-share estimate may still be low. International earnings should be up 10%, which also may be conservative factoring in last year's bad debt expense.

- **Fiscal 1993 prospects.** Mr. Chicoine half joked that he had no idea what the company would earn in fiscal 1993. Planted acreage prospects depend on this year's crop, which won't be harvested until October. Yields become more visible in July and August. Seed crop prospects also depend on yields, despite the increase in irrigation to nearly 40% of the seed acreage. Grower payments, which represents

2031660299

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

approximately 60% of production costs, have been locked in at an average price of approximately $2.35 per share versus a current cash corn price of $2.50. Assuming good yields, production costs should be over $1.50 per bag lower in fiscal 1993, which alone works to $0.30 per share. (See Table 11.) Without substantial market-share gains, we can get $5.00 per share in fiscal 1993 earnings. Management didn't disagree with our analysis and even suggested an upside to $5.05 per share in its early range.

- **Long term.** Although Pioneer is a company that can be unpredictable year to year, it is more predictable over a three-to-five year time frame. From our perspective, PHYB was a growth company with a drug multiple during the 1975-to-1985 period when earnings grew at a 17.5% average rate. From 1986-to-1990, PHYB became a commodity stock with volatile periods, leaving no net earnings advances. Now with advances in relative yields, acreage and prices, PHYB appears to be in a new five-year (or more) period of at least mid-double-digit earnings growth, caused by market-share gains and global increases in acreage.

Mr. Chicoine was as bullish as we are about further market-share gains domestically, given the better germplasm protection and the fragmented industry. Outside the United States, greater use of hybrid seed (instead of varietal) enhances the growth story. So does the European market share showing a 60% share in Italy, 34% in France, 25% in Germany, 35% in Spain, and 30% in Austria. While a G.A.T.T. agreement may hurt acreage prospects in the region, international growth is a big part of the new PHYB story. Year to year, crops will determine near-term earnings. But over a five-year period when weather should average out, PHYB should reach its 20% return on equity goal.

Table 11. Corn Segment Earnings Model
(Per Unit)

	1985	1986	% Change	1987	% Change	1988	% Change	1989	% Change	1990	% Change	1991	% Change	1992E	% Change	1993E	% Change
Price Per Unit-North America	$62.28	$62.02	-0.4%	$60.92	-1.8%	$60.05	-1.4%	$66.80	11.2%	$68.97	3.2%	$70.07	1.6%	$73.00	4.2%	$73.31	0.4%
Sampling Costs	(0.05)	(0.10)	100.0%	(0.50)	400.0%	(0.70)	40.0%	(0.67)	-4.3%	(2.03)	203.0%	(0.29)	-85.7%	(0.35)	20.7%	(0.50)	42.9%
Net Unit Price	$62.23	$61.92	-0.5%	$60.42	-2.4%	$59.35	-1.8%	$66.13	11.4%	$66.94	1.2%	$69.78	4.2%	$72.65	4.1%	$72.81	0.2%
Production Costs	(23.37)	(18.38)	-21.4%	(17.62)	-4.1%	(15.09)	-14.4%	(20.22)	34.0%	(19.77)	-2.2%	(19.02)	-3.8%	(21.50)	13.0%	(18.75)	-12.8%
Inventory Writedowns	(1.50)	(4.59)	206.0%	(1.35)	-70.6%	(1.34)	-0.7%	(0.80)	-40.3%	(1.43)	78.7%	(1.91)	33.6%	(1.25)	-35.6%	(1.50)	22.0%
Gross Margins	$37.36	$38.95	4.3%	$41.45	6.4%	$42.92	3.5%	$45.11	5.1%	$45.76	1.4%	$48.85	6.8%	$49.92	2.2%	$52.56	5.3%
Operating Expenses	(18.25)	(21.32)	16.8%	(24.03)	12.7%	(25.48)	6.0%	(28.58)	12.2%	(29.83)	4.4%	(29.63)	-0.7%	(29.00)	-2.1%	(29.00)	0.0%
Operating Margins	$19.11	$17.63	-7.7%	$17.42	-1.2%	$17.44	0.1%	$16.53	-5.2%	$15.91	-3.8%	$19.22	20.8%	$20.92	8.8%	$23.56	12.6%
# Of Bags Shipped	9.25	8.73	-5.6%	7.24	-17.1%	7.45	2.9%	7.67	2.9%	8.37	9.2%	8.89	6.2%	9.75	9.6%	9.91	1.6%
Op. Profit-N.A. (in millions)	$176.8	$153.9	-13.0%	$126.1	-18.1%	$129.9	3.0%	$132,9	2.3%	$133.2	0.2%	$170.9	28.3%	$204.0	19.4%	$233.5	14.5%
Europe Operating Profit	43.3	53.9	24.5%	51.9	-3.7%	60.6	16.4%	50.6	-16.6%	55.0	9.1%	78.0	41.8%	85.0	9.0%	93.0	9.4%
Other Int'l Op. Profit	(8.00)	(8.00)	0.0%	(8.01)	0.1%	(7.58)	-5.4%	(5.82)	-23.2%	(3.27)	-43.8%	(0.30)		2.00		5.00	
Total Int'l Op. Profit	35.3	45.9	30.0%	43.89	-4.4%	52.82	20.3%	44.58	-15.6%	51.73	16.0%	77.70	50.2%	87.00	12.0%	98.00	12.6%
Total Corn-Op. Earnings	212.1	199.8	-5.8%	170.0	-14.9%	182.7	7.5%	177.5	-2.9%	184.9	4.2%	248.6	34.4%	291.0	17.1%	331.5	13.9%

Sources Prudential Securities.

2031660300

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

On a less fundamental basis, we also learned that PHYB may soon be listed on the New York Stock Exchange. The board has not yet made a definitive decision, but an application could be in the works. We also think a stock split and dividend increase is in the offing.

While we remain committed to the long-term fundamental story, we believe better tradability should help PHYB's multiple. Despite a $2.3 billion market capitalization and no debt, PHYB has very little sponsorship on Wall Street. We see that changing due to a pipeline filled with new products that enhance the stock's image as a drug company again. The F.D.A's favorable decision on allowing food products made from genetic crosses to go to market without long studies should add to this image.

If both biotechnology and international opportunities accelerate further, investors may pay over 20 times those 1995 earnings which return 20% against equity. By our calculation, this would leave a $130 stock. Watching the stock double in the last year, investors may feel that they have missed PHYB. But remember the stock did nothing from 1985 to 1991. A stock that has only doubled in seven years still could have a lot of upside, in our opinion.

QUAKER OATS COMPANY (OAT--56 1/4) -- NYSE
MANAGEMENT VISITS PHILADELPHIA AND BALTIMORE **Hold** (*Low Risk*)

	Earnings Per Share* Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	6/91	6/92E	6/93E	1993E	Div.	Yield	(Mil.)	Range
New	$3.13	$3.15	$4.00	13.4X	$1.72	3.1%	73.9	76-50
Old		3.10						

* From operations.

We hosted analysts' meetings for The Quaker Oats Company in Philadelphia and Baltimore on May 26, 1992. After a strong shipment month in April 1992, Chairman William Smithburg was feeling confident about achieving Wall Street's revised expectations for fiscal 1992 ($3.05 per share to $3.20) and fiscal 1993 ($3.80 to $4.00). Relatively stronger consumer takeaways (or Nielsen market shares) for Quaker's major brands supported his viewpoint.

We left believing our $3.10 per-share estimate for fiscal 1992 was too conservative. As a result, we are raising our fourth-quarter projection by $0.05 per share to $1.28 per share versus $1.46 from operations. This would leave fiscal 1992 earnings of $3.15 per share. We also left more optimistic that the $0.40 per share in earnings lost by the elimination of fiscal year-end trade loading would be recaptured in the first half of fiscal 1993. Management compensation programs are based on the return of these earnings.

2031660301

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Although we are pleased with the improved earnings visibility, we find OAT a difficult stock to upgrade at the moment. Business challenges are present, which Mr. Smithburg discussed frankly:

- **Accelerated sports beverage competition.** Gatorade's 90% share of a $1 billion (at retail) domestic sport beverage category is a formidable position for anyone to crack. Obviously, Coke and Pepsi have enviable distribution to vending machines and some other outlets that Gatorade would want. But Gatorade is already well entrenched at most point of thirst locations, and Quaker management is ready to fight the big boys nationally if needed. With Pepsi now rolling out its All Sports beverage to three new test markets (mostly in the Northwest) and with Coke rolling out Powerade to four retail markets (in the Southeast), competition is clearly accelerating.

As management is now doing with Pepsi's All Sport in Minneapolis, Quaker will aggressively fight competition in test markets in hopes of stopping a national rollout. However, by the summer of 1993, a national rollout by either All Sport or Powerade looks probable. With multi-year deals locked up with the three big sports leagues, Gatorade should win the battle and may even see increased category growth.

But what happens to profit growth for this product that provides 20% of Quaker's earnings? Mr. Smithburg talked about the ability to hold Gatorade's profits, which seem plausible unless a three-player national war breaks out. But to achieve its target of 7% real annual growth, Quaker needs growth from Gatorade. With all this uncertainty about the level of commitment by the two soft drink giants, we find it hard to forecast fiscal 1993 and 1994 earnings.

- **Payback from European Gatorade expansion.** By our calculations, expansion of Gatorade in Europe may penalize fiscal 1992 earnings by $0.15 per share. Not only have inroads in Spain and France been difficult to achieve, but core operations in Italy have slowed owing to new competition, a cold 1991 summer, and a VAT tax increase. Clearly, management needs distribution leverage to grow Gatorade in Europe. With a joint venture with Coca-Cola now out of the question, Quaker needs to get joint venture partners (like Cadbury Schweppes) quickly. While management may make an announcement soon, we find it difficult to get excited until we get more information.

An announcement about the divestiture of its Cuore corn oil business in Italy is also possible over the next few months. We believe Quaker can get net proceeds of $175 million, even though it will retain distribution rights for its Gatorade, cereal, and pet food products in Italy.

- **Better cereal trends.** Through the first nine months of fiscal 1992, cold cereal volumes were down 6% and hot cereal volumes were down 7%. Thankfully, April shipments for cold cereals were so strong that ten-month volumes are now flat. However, tonnage

2031660302

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

concerns are still present. Mr. Smithburg pointed out that new product introductions for both hot and cold cereals were in the works, which may help fiscal 1993. Nonetheless, combining European and domestic operations, cereals have been a soft spot for Quaker in fiscal 1992 and substantial evidence of improvement is still not visible to us at the moment.

Hot cereals are a key profit area for Quaker, as seen by Table 12. Unquestionably, the category has been hurt by aggressive cold cereal promotions by Kellogg and General Mills. Moreover, the new product expansion in cold cereals featuring fiber, health oats, and all the other attributes of hot cereal has hurt Quaker's core business. With a Raisin Bran hot cereal planned, Quaker is fighting back. Management also indicated that it has planned a major new cold cereal introduction for the second half of fiscal 1993.

Table 12. The Quaker Oats Company At A Glance
(Dollar Amounts In Millions)

							Pound Volume Growth					
U.S. & Canadian Grocery:	FY 1992 Revenues	Est. % Of F'92 Rev.	Est. % Of FY 92 Earnings	Major Brands	Dollar Market Share	Market Position	F'87	F'88	F'89	F'90	F'91	10-Month F'92
Cereals – Hot	$375	7%	16%	Quaker Oatmeal,	66%	#1	-5	20	9	-8	-4	-5
RTE	450	8	15	Cap'n Crunch, Life	7	#4	10	16	3	-9	2	0
Total Cereal	$825	15	34		13	#3	3	18	6	-8	-2	-5
Sports Drink	700	13	21	Gatorade	69	#1	50	29	21	2	17	4
Dog Food	525	9	5	Ken-L-Ration, Gaines, Cycle	18	#2	3	9	-11	-22	3	8
Foodservice	525	9	4	Ardmore Farms	NA	NA	30	22	9	6	0	10
Canada	250	5	3	Quaker	NA	NA	11	3	6	0	-3	-2
Rice & Noodle	325	6	6	Rice-A-Roni, Noodle Roni	34	#2	1	20	-7	-7	3	4
Pork & Beans	135	2	1	Van Camp's	27	#1	-7	0	-7	-2	2	0
Syrup	200	4	3	Aunt Jemima	18	#2	1	2	-7	0	6	-15
Other Aunt Jemima	100	2	2	Frozen Mixes								
Grain Based	110	2	2	Quaker, Rice Cake	40	#1	-30	-7	-20	1	6	0
Other	55	1	1	Celeste, Puss'n Boots								
Total U.S. & Canada	$3,750	66%	79%				6	9	0	-6	5	2
International Grocery:												
Europe:												
Pet Foods	$800	15%	18%	Fido, Bonzo, Felix	17%	#2					5	6
Cereals	225	4	4	Quaker	12	#2					-2	-5
Corn Oil	140	3	4	Cuore	NA	NA						
Sports Drinks	125	2	(5)	Gatorade	NA	NA					25	-5
Other	110	2	0	--								
Latin America and Pacific	350	6	0	ToddYnho, Coquiero, Gatorade	NA	NA					3	24
Total International	$1,750	32%	21%				4	6	6	4	5	2
Total Company	$5,500	100%	100%									

NA: Not Available

Source: Prudential Securities.

In summary, OAT is a cheap stock that we regard as a candidate for an investment upgrade. But with these uncertainties, we find it difficult to pull the trigger again. We should also note that the company's 2 million share buyback program should not begin in earnest until July 1, 1992, due to European tax credits based off the debt/equity ratio.

One uncertainty that Mr. Smithburg took extra time to reduce is the depth of Quaker's management. After Giulio Malgara's departure, we wrote a brain drain piece that pointed out all the executives (CFO

2031660303

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Paul Price, European heads Mike Callahan and Malgara, President Frank Morgan, grocery executives Jim Tindall and Laurie Hathaway) who have left Quaker in recent years. Mr. Smithburg took obvious exception to this piece pointing out the individual issues (retirement, travel, promotion) behind all of these moves. He also spent considerable time talking about the number of brand managers and senior executives that have grown up and stayed at Quaker. We had to acknowledge that the management backbone of the company had remained more stable than what you might assume reading the newspaper.

As far as additional restructuring is concerned, Mr. Smithburg doesn't see much on the acquisition front. In fact, the company has made no purchases in the last three years after the 1986-to-1988 binge. Prices have been too high, according to the executive, who seems more financially driven than in the past. Marketing is fun, but in these times of limited price increases, cost control is paramount and Mr. Smithburg has adjusted to the changing times. This should also help deliver profit growth even if sport beverage competition accelerates.

SARA LEE CORPORATION (SLE--51) -- NYSE
REVIEW OF U.S. FOOD SEGMENT **Hold** (*Low Risk*)

	Earnings Per Share* Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	6/91	6/92E	6/93E	1993E	Div.	Yield	(Mil.)	Range
New	$2.09	$2.39	$2.70	17.6X	$1.00	2.0%	250.0	58-37
Old								

* Fully diluted from operations.

Sara Lee held an interesting quarterly analysts' meeting on May 27, 1992, in New York. C. Steven McMillan, U.S. Foods head, discussed his $5 billion segment, which most analysts, including us, regard as the weak link within the company. While Mr. McMillan didn't quite alter our opinion, he did leave us more confident that cost-control efforts would lead to 10% average annual earnings growth for this large business segment.

Table 13 shows that U.S. Foods accounted for 41% of total company revenues in fiscal 1991 but only 21% of profits. Only five years ago, U.S. Foods was Sara Lee's biggest segment, representing nearly 40% of company profits in fiscal 1987. Despite the acquisition of Hygrade meats, management's strategic direction for Sara Lee has been twofold. The greatest emphasis has been to expand internationally, which we discussed in our 1992 *Florida Food Conference* piece titled "Global Thrust." The second major effort has been to expand its personal products portfolio to include socks, foundations, Champion activewear and other products.

2031660304

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 13. Sara Lee Corporation At A Glance
(Dollar Amounts In Millions)

Category	Estimated FY91 Revenues	Estimated % Of FY91 Revenues	Estimated % Of Total FY91 Profit	Volume Growth '86	'87	'88	'89	'90	'91	Nine Months '92
Packaged Meats	$3,000	24%	14%	8	8	7	7	5	0	1
Bakery	800	6	3	8	8	10	6	(3)	(2)	(1)
Foodservice	1,324	11	4	9	5	10	1	7	3	7
Total Segment	$5,124	41%	21%							
European Coffee	$1,100	9%	15%	7	5	7	(1)	(2)	2	(5)
Out of Home Beverages	175	2	1							
Grocery	663	5	7							
Total Segment	$1,938	16%	23%							
Total Food	$7,062	57%	44%							
Hoisery–Worldwide	$1,400	11%	24%	9	10	2	4	2	1	2
Knitwear	1,225	10	11	10	16	25	24	17	6	10
Foundations	200	2	3	NA	NA	NA	NA	8	6	9
Champion	250	2	2							
Coach & Direct (Catalog)	650	5	3							
Other (Isotoner)	379	3	2							
Total Segment	$4,104	33%	45%							
Insecticides	145	1%	1%							
Shoe–Care (Kiwi)	175	1	2							
Personal–Care	275	2	3							
OTC Drugs (Now divested)	205	2	4							
Other	416	3	1							
Total Segment	$1,216	9%	11%							
Total Non–Food	$5,320	41%	56%							
Total Sara Lee*	$12,381	100%	100%							

* Intercompany sales total over $3 million.
NA Not available.

Source: Prudential Securities.

Mr. McMillan didn't try to deny the fact that U.S. Foods has been deemphasized as a source of company volume growth. But he tried his hardest to convince everyone that a lot of emphasis is being placed on expanding the segment's profitability. Sounding a bit like a corporate raider, the executive explained how a streamlined frozen baked goods product line and nine meat plants closings would stimulate margin growth.

Sara Lee's trademark is to leverage its strong brands. However, its portfolio of nonfood brands (Hanes, L'Eggs, Champion, Kiwi, Coach, Isotoner) is considerably stronger than its U.S. Foods brands.

2031660305

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Nonetheless, Mr. McMillan walked us through the two core businesses and explained what costs were being taken out of the system and what other moves were being made to improve margin growth.

• **Packaged meats.** With a $0.51 per-share restructuring charge taken in the first fiscal quarter of 1992, Sara Lee has reserved for the costs to close a number of its meat plants. In fiscal 1992, the number so far has been four, but management hinted that more consolidation is likely. Investors have to remember that Sara Lee's meat division was built through acquisitions of a number of regional companies. (Note Table 14.) Plant overlaps between these various companies exists, which management resisted fixing because the business was growing. Now with tonnage stabilizing, plants are being closed and operating efficiencies (modern equipment) are being added to the remaining facilities.

Table 15 breaks down the $20 billion domestic packaged meats category. As can be seen, Sara Lee's various purchases and ConAgra's acquisition of Swift Eckrich has helped to consolidate the industry. This consolidation, combined with weak hog prices over the last 12 months, has helped improve industry returns, in our opinion. Oscar Mayer has also taken capacity out of its system.

Interestingly, the other group of small regional meat companies has held its ground fairly well over the last six years. In contrast to beer where local tastes and brands have disappeared, the packaged meat industry is highly regional with Southerners preferring red hot dogs and Northeasterner wanting only all beef. Sara Lee's regional network of meat companies wouldn't work in many other categories, but it seems to be working toward gaining share against Oscar Mayer. Most importantly, Oscar Mayer's Louis Rich brand has suffered some problems as the turkey category has slowed.

Table 16 shows Sara Lee's major packaged meat brands and market positions. The division is run out of four autonomous operating units that can compete with each other. Competition, notably Oscar Mayer and ConAgra, has centralized its management, leaving Sara Lee with a competitive advantage, according to Mr. McMillan.

• **Bakery** operations are recovering from a difficult two-year period where volumes fell over 5%. Part of this lost volume was intentional, given the low profitability of some small product lines. Mr. McMillan's emphasis has been to stimulate major lines where margins are higher. Media advertising and targeted promotion has helped tonnage trends for pound cake and cheese cake. However, Mr. McMillan admitted after the meeting that the use of Sara Lee (the actual women) in commercials is being moderated, which we endorse. Commercials should make us hungry.

Sara Lee has a leading 21.9% share of the $900 million frozen baked goods category. Mrs. Smith, a division of Kellogg Co., is next with 17.4%, but the retail pie company doesn't compete directly with Sara Lee. Kraft (15.6% share) does compete directly with its Lenders

2031660306

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Bagel products. In the question-and-answer period, Mr. McMillan acknowledged that Entenmann's fresh product, which is delivered frozen, is direct competition.

From our perspective, the reason for the decline in the frozen baked goods category is that consumers want products fresh. In-store bakeries are the growing rage (note Flowers Industries company visit) and Mr. McMillan has focused his bakery on serving this $4.5 billion market. Foodservice frozen baked goods, sold under the Chef Pierre brand, is the largest bakery unit, holding 33% of a growing $900 million category.

Table 14. Packaged Meat Growth Via Acquisitions

Regional Meat Company Acquired	Year	Acquired # Of Plants
Kahn's	1966	3 plants
Bryan's	1968	3 (plus 1 CEO)
Hi-Brand's	1969	3
Rudy's Farm	1971	3
Hillshire	1971	1
Gallo Salami	1979	1
Standard Meat	1983	3
Peck Meat	1984	2
Jimmy Dean	1984	2
R. B. Rice	1984	2
Buring Foods	1985	2
Galileo-Capri Salami	1985	1
Green Hill	1986	1
Sweet Sue	1987	0
Hygrade	1989	5

Source: Sara Lee Corporation.

Table 15. The $20 Billion U.S. Packaged Meats Industry

	1992 Market Share	1985 Market Share
Oscar Mayer	18 %	21 %
Sara Lee	18	7
ConAgra	10	6
Swift Eckrich	--	5
Hygrade	--	4
Other	54	57
	100 %	100 %

Source: Sara Lee Corporation

2031660307

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

Table 16. Sara Lee's Packaged Meat Brands And Shares

Category	Major Brands	Est. '91 Rev.	Market Share	Major Competitor
Hot Dogs	Kahn, Ball Park	$350	22 %	Oscar Mayer--20%
Smoked Sausage	Hillshire Farms	300	22	ConAgra--18%
Breakfast Sausage	Jimmy Dean	200	38	ConAgra--15%
Luncheon Meats	Mr. Turkey	250	12	Oscar Mayer--35%
Bacon	Bryan	75	3	Oscar Mayer--18%
Canned Poultry	Sweet Sue	20	37	
Other Retail	Rudy's	555		
Foodservice	--	1,250		
		$3,000		

Source: Prudential Securities and Sara Lee Corp.

Mr. McMillan didn't totally forget foodservice distribution. But his two-minute comments that PYA Monarch wasn't a core business only enhances divestiture rumors. The executive downplayed these rumors in the question-and-answer period, pointing out the health of the southeastern business. But longer term, business growth is being deemphasized, even more so than the other U.S. Foods businesses.

Mr. McMillan also did not totally forget volume-growth strategies. He said that low-fat products offered opportunities in packaged meats. However, making inroads in diet frozen baked goods has been more difficult. Mr. McMillan also stressed geographic expansion, particularly in Mexico and domestic warehouse stores. Acquisitions were not dismissed, but only if small niche moves would expand distribution.

In summary, we were impressed again by Mr. McMillan, who we should add is no relation to us or to the Cargill's McMillians. He took on a difficult task with Sara Lee's bakery, and, while the jury isn't in, the early indications are better. We feel his goal of 8% to 12% earnings growth for U.S. Foods is achievable through fiscal 1995. Our only problem is what multiple to pay for them. Sustaining growth is usually volume driven. Thankfully, the personal products segment is delivering enough of that to keep investors happy. Moreover, with media advertising expenditures up 24% in the third fiscal quarter of 1992 and promotional expenditures up 25%, it's hard to accuse Sara Lee of poor earnings quality right now. All of this should keep SLE firm at $50, even if the stock is a bit too expensive for us to buy.

2031660308

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

UST, Inc. (UST--29 1/2) -- NYSE
UPBEAT ANALYSTS' MEETING **Buy** *(Low Risk)*

	Earnings Per Share Fiscal Year Ending			P/E	Ind.		Shares O/S	52-Week
	12/91	12/92E	12/93E	12/93E	Div.	Yield	(Mil.)	Range
New	$1.17	$1.40	$1.65	17.9X	$0.80	2.7%	220	34-21
Old								

UST held two analysts' meetings in May, one small meeting just before the annual shareholders meeting on May 5, 1992, and another larger meeting a week later over lunch in New York City with the Consumer Analysts Group of New York. The same upbeat presentation was delivered to both groups. Chairman and CEO Louis Bantle attended the first meeting, and the second was led by President and Bantle heir-apparent Vincent Gierer.

Volumes of 5% expected. Bantle stated that he is comfortable with a forecast of 3 to 5% volume growth over the long term. He implied that UST can achieve better than 5% annual volume growth. Success with new Skoal long cuts in four flavors and a more focused retail setting effort are two cushions that should hold growth up above 5% levels.

We also believe that smoking restrictions push smokers to smokeless tobacco products like moist snuff. Changes in the workforce and social acceptance of snuff among white-collar workers are other growth propellants. Moist snuff is popular with college students. A more educated workforce today compared with the past could be helping UST sales because young workers bring their habits with them from schools. The recent recession has not hurt UST volume trends like past recessions have. This could be an indicator of a broader user base.

Pricing should stay at 10% annually, although the schedule of price increases is more consistent now than in the past. A July-December pattern has emerged in the last four years with no consumer reaction. Two small bi-annual increases are easier to stomach than one large annual move. In the past, distributors have resisted pricing more than consumers. But they cannot load up on products in advance of predicted price moves because the products are dated for freshness.

Manufacturing capacity adequate until 2007. UST's two production plants have some bottlenecks that need to be cleaned up in the next five years. If these are cleared, manufacturing capacity is probably sufficient to meet production needs until 2007. The plants are conveniently located near tobacco fields and distribution centers.

Bantle will retire in 1993. After 20 years as chairman, Louis Bantle plans to retire in 1993. He feels confident in management under him. Heir-apparent and president Vincent Gierer has begun meeting with analysts and seems to be a knowledgeable and capable company leader. Some investors worry that he will stray off on a diversification path

2031660309

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

that would dilute returns. He emphasized that he plans no major changes in the corporate strategy. His priorities are these:

- Sell more cans of snuff in the United States. Of course, this remains the top priority of the company, which determines the fat of the market because of its over 85% market share.

- Develop international markets where UST currently has very little presence. Privately, he told us that test markets are active in Mexico, where there is a powerful emerging consumer economy.

- Evaluate the wine business to decide whether to grow or divest it. Stimson Lane, which is known principally for the premium wine label Chateau Ste. Michelle, has recently emerged as a leader in marketing value-priced quality wines with its Columbia Crest label.

- Sustain the company's high cash flow.

Most employees are shareholders. UST employees have tremendous team spirit when it comes to stock ownership. While a lucky one third of them receive stock options, 90% are stockholders. The number of options granted has been reduced in the last two years so that the impact of share repurchases benefit outstanding shareholders more. Options are granted to employees at lower management levels in the past, which should build loyalty among the ranks.

Aggressive share repurchase will continue. UST is about halfway through a 40 million share repurchase program. In the first quarter, 1.2 million shares were repurchased at an average cost of $29.25. The total spent was $35.1 million. Our estimate for share repurchase spending for 1992 is $190 million, which is in line with management intentions to step up share repurchase efforts in subsequent quarters.

Stock is a Buy. We continue to rate UST shares a Buy. Their solid, stable growth and excellent returns are not fully reflected in the stock price, in our opinion.

UNIVERSAL CORPORATION (UVV--25 3/4) -- NYSE
POSITIVE LONG-TERM OUTLOOK--
NEGATIVE SHORT-TERM EARNINGS MOMENTUM **Hold** (*Low Risk*)

	Earnings Per Share Fiscal Year Ending			P/E	Ind.		Shares O/S	52-Week
	6/91	6/2E	6/93E	6/93E	Div.	Yield	(Mil.)	Range
New	$1.72	$2.10	$2.40	10.7X	$0.80	3.1%	32.8	34-16
Old								

Some investors can't handle agriculturally based companies, and their managements often have problems with Wall Street. Worried investors are uncomfortable with unpredictable or seasonal quarterly earnings

2031660310

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

patterns. Quarterly blips do not slide easily through quant screens or analysts' spreadsheets.

Universal Corporation is an example of such an agriculturally based company. Management came to New York on May 20, 1992, to try to reassure investors. Universal's business seems to be on track, even though earnings in the seasonally low fourth quarter should be barely over break-even. The stock, which has reflected the earnings outlook, has sold off 28% from its high of 33 7/8. It's probably approaching a buying point, but we don't think it's worth rushing into.

Vice-President and Treasurer Kemp Dozier gave an excellent overview of the business. Universal is the world leader in tobacco processing with a 28% share of the top five world markets for flue tobacco and 38.5% for burley. Universal holds 43.3% of the largest market, the U.S. flue-cured, and an even higher 48.2% of the U.S. burley market. (See Tables 17 and 18.)

Table 17. Universal Leads In The World's Top Flue-Cured Tobacco Markets

Country	1989	1990	1991	1992E	Universal Market Share
US	836	917	888	924	43.3%
Brazil	587	591	572	715	22.9%
Zimbabwe	286	295	374	440	33.8%
India	268	248	286	363	3.0%
Argentina	105	95	121	165	10.0%
Top Five	2,082	2,146	2,241	2,607	28.4%
Others	1,484	1,550	1,670	1,663	
Total	3,566	3,696	3,911	4,270	

Sources: USDA; Universal Corp.

Table 18. Universal Also Leads In The World's Top Burley Tobacco Markets

(Millions of Pounds) Country	1989	1990	1991	1992E	Universal Market Share
US	497	589	638	649	48.2%
Malawi	134	140	165	209	49.4%
Brazil	131	115	116	176	18.2%
Italy	76	107	121	97	19.3%
Argentina	44	36	58	90	2.8%
Top Five	882	987	1,098	1,221	38.5%
Others	567	555	648	725	
Total	1,449	1,542	1,746	1,946	

Sources: USDA; Universal Corp.

These two tobacco types compose 70 to 90% of the tobacco in the American-blend cigarette, which is growing in demand worldwide.

2031660311

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

According to studies recently completed by the USDA and the Foreign Agriculture Service, demand for American blend tobacco will grow 6% through the end of the century. This assumes that global demand for all tobacco grows over 2% and that the American blend grows from approximately 30% in 1990 to 40% in 2000. Some cigarette producers, which are experiencing higher sales growth, estimate that the American blend will take 50% of all tobacco demand by the year 2000. This implies demand could grow as much as 9% in that time. (See Table 19.)

Table 19. Components Of The American Blend Cigarette.

Tobacco Type	Range
Flue-cured	45%-55%
Burley	25-35
Oriental	10-25
Light air-cured	1-3

Sources: USDA, Universal Corp.

Positive Outlook For Processing Volumes

The outlook for processing volumes in positive in the United States and Brazil. Although the U.S. flue-cured crop will probably only rise about 2% to 900 million pounds, there is a carryover of 70 million pounds, or about 8%. The crop is going into the ground, and conditions look fine. Brazil has a bumper crop. Capacity has been expanded in Brazil and is adequate in the United States to handle 10% to 15% more volume.

Vice President and Chief Financial Officer Hartwell Roper reviewed the earnings results and outlook. Third-quarter earnings from operations rose only 6% to $0.57 per share from $0.54. The number was $0.02 shy of our recently reduced estimate for the quarter and the growth rate suffered because last year's number on a split basis was $0.01 higher than we had calculated.

- **Revenues rose a healthy 14% in the quarter**, thanks to a larger burley tobacco crop in the United States. We estimate the crop size grew over 10%. Tobacco leaf processing is a volume-driven business, so a larger crop creates the environment for sales and earnings growth. Brazil also contributed to growth in the quarter both for economic reasons and agricultural reasons. Processing volume rose over 30%.

- **Interest expense was also a big positive,** thanks to lower rates in the United States and Brazil. The balance sheet is approaching management's target of a 35% long-term debt-to-capital ratio. However, the rating agencies look at total debt to capital. Universal's high short-term borrowings keep this measure over 50%, which is a threshold the company needs to penetrate to possibly qualify for a credit-rating upgrade.

2031660312

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

• **The tax rate was a high 40% in the quarter** versus 31% in last year's third quarter. Our estimate for the year is now 36%. The high rate reflects some unusual, nonrecurring conditions in some foreign businesses, some of which could be reversed next year. Last year the tax rate was abnormally low because of two one-time tax credits. The recent tax rate change hurts earnings growth but helps earnings quality. Roper is being very conservative with tax accounting. He is accruing for foreign earnings, which will smooth out some potential swings in the tax rate.

It is clear that quarterly earnings momentum is over for now. Starting with the second quarter of fiscal year 1991 (quarter ending December, 1990), the quarterly earnings growth progression is 3%, 17%, 150%, 121%, 11%, and 6%. We expect the next quarter to show a negative rate of growth. Our estimate is $0.02 versus $0.10.

We are maintaining our Hold rating on the stock. We continue to like the long-term earnings story based on a secular growth rate in global demand for American-style tobacco leaf. However, earnings can be unpredictable because this is a commodity business, exposed to agricultural, economic, and varying accounting factors worldwide. We view these as a short-term negative for earnings. We think the stock needs more earnings visibility before it will outperform the market.

Table 20. Universal Corporation
Third-Quarter Consolidated Earnings
(Dollar Amounts In Thousands)

	31-Mar-91	31-Mar-92	% Change
Sales	828,092	941,548	13.7%
COGS	734,853	839,775	14.3%
Gross	93,239	101,773	9.2%
SGA	54,360	59,229	9.0%
Operating	38,879	42,544	9.4%
Interest Expense	16,973	12,698	-25.2%
Pretax Income	21,906	29,846	36.2%
Taxes	6,799	11,951	
Rate	31.0%	40.0%	
Minority Interests	(423)	(868)	
Net Income from Operations	14,684	17,027	16.0%
Equity in Affiliates	2,727	1,768	-35.2%
Net Income	17,411	18,795	7.9%
EPS	$0.54	$0.57	5.6%
Shares Outstanding	32,797	32,809	0.0%
Dividends Declared	$0.19	$0.20	5.3%
Expense Ratios			
COGS	88.7%	89.2%	
SGA	6.6%	6.3%	
Profit Margins			
Gross	11.3%	10.8%	
Op	4.7%	4.5%	
Pretax	2.6%	3.2%	
Net	2.1%	2.0%	

2031660313

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

QUARTERLY EARNINGS SCORECARD:

CAMPBELL SOUP (CPB--34 1/4) -- NYSE
FINETUNING ESTIMATES TO REFLECT
ACCELERATED SPENDING AND FROZEN DIFFICULTIES **Buy** (*Low Risk*)

	Earnings Per Share Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	7/91	7/92E	7/93E	1992E	Div.	Yield	(Mil.)	Range
New	$1.58	$1.92	$2.20	14.6X	$0.78	2.3%	251.3	44-33
Old		1.95	2.25					

Campbell's two major goals in fiscal 1992 have been to achieve 20% earnings growth and to stimulate volume growth. Third-fiscal-quarter results show a company on track with achieving these objectives despite intense competitive conditions and a relatively warm winter.

Earnings for period ending April were $0.36 per share versus $0.30, up 20% but a bit below our $0.37 estimate. We understand management's bonuses in fiscal 1992 are triggered off the attainment of 20% earnings growth. With an extra week in the fiscal quarter this year, $1.90 per share (or 20% growth) looks relatively easy. But getting to our $1.95 per-share projection is unlikely given management's second objective to stimulate volume growth.

- **Soup volumes in the third fiscal quarter rose a healthy 5.8%, excluding acquisitions...** While heavy April promotions helped this tonnage gain, Campbell's soup business got through this relatively warm winter in great shape. With soup accounting for 50% of Campbell's earnings, investors should recognize that when soup is fine, Campbell is fine. The soup volume comparison was also not easy, given the 4% gain in last year's third quarter.

- **...However, the volume improvement has not come cheaply.** Total advertising and promotional spending was up 11% in the quarter. Not many companies record 20% earnings growth with a double-digit marketing increase.

Investors, of course, want it both ways. Last year, everyone was crying that earnings gains in the mid-20s were meaningless given the volume drops. Now volumes are picking up, but earnings growth is moderating.

Although our Buy rating may be diluted by our lower earnings forecast, it is enhanced by the improving volume trends. At only 14.6 times estimated calendar 1993 earnings, CPB sells at a 16% discount to the S & P Industrials using a consensus 28.34 forecast. We believe the stock deserves at least a 5% to 10% premium, which gives us a target price of between $43 and $45.

The quarter's income statement showed 3% sales growth, owing to 1.6% internal volume growth, unfavorable currency comparisons, and divestitures. Frozen volumes fell 13% versus a year-ago comparison

2031660314

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

when tonnage was off 8%. Clearly, management is faced with a difficult frozen industry environment, both here and in The United Kingdom. Nonetheless, the U.S. frozen business is still profitable, which is probably more than ConAgra or Nestle can say right now.

Shares outstanding were off only 0.7%. Management has not begun to actively implement its 6 million share repurchase program, which may indicate that an acquisition is in the offing.

The following table breaks down the third quarter.

Table 21. Campbell Soup's Third Quarter
(Dollar Amounts in Millions, Except Per Share)

	4/28/91	4/26/92	% Change
Sales:			
Campbell U.S.A.	948.5	1,008.7	6.3%
Campbell Canada	85.4	83.9	-1.8%
Pepperidge Farm	134.4	141	4.9%
International Biscuit	49.4	46.5	-5.9%
International	295.2	271.9	-7.9%
Interdivision	-22.1	-15.7	-29.0%
Total Sales	$1,490.8	$1,536.3	3.1%
Operating Income:			
Campbell U.S.A.	134.4	146.1	8.7%
Campbell Canada	8.8	9.6	9.1%
Pepperidge Farm	12.9	13.4	3.9%
International Biscuit	1.8	2.9	61.1%*
International	11.7	8.9	-23.9%
Total Operating Income	$169.6	$180.9	6.7%
Unallocated Corp. Exp.	(19.7)	(8.4)	-57.4%
Interest Expense, Net	(20.5)	(21.7)	5.9%
Foreign Currency	3.1	(0.5)	-116.1%
Pretax Income	132.5	150.3	13.4%
Taxes	(56.1)	(58.8)	4.8%
Tax Rate	42.3%	39.1%	-7.6%
Net Income	76.4	91.5	19.8%
E.P.S.	$0.30	$0.36	20.0%

GERBER PRODUCTS (GEB--63 7/8) -- NYSE
OPERATING TRENDS A BIT BELOW EXPECTATIONS--
FINE-TUNING FY93 ESITMATE, BUT STOCK IS CHEAP **Buy (*Low Risk*)**

	Earnings Per Share Fiscal Year Ending			Cal. P/E	Ind.		Shares O/S	52-Week
	3/92*	3/93E	3/94E	1993E	Div.	Yield	(Mil.)	Range
New	$3.85	$4.35	$4.90	13.0X	$1.44	2.3%	39.2	79-59
Old		4.40	5.00					

* Includes $0.05 tax gain in fiscal 1992 but excludes apparel restructuring charge of $0.43.

Although fourth-fiscal-quarter earnings of $1.18 per share were on target with our estimate, we were a little disappointed with the release.

2031660315

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000

A favorable tax audit resulted in an abnormally low 32.9% tax rate in the quarter, which added approximately $0.05 per share. Excluding this item and the $0.40 apparel charge for the Weather Tamer divestiture in 1991's fourth quarter, earnings from operations were $1.13 versus $1.01, up 12% but below our $1.18 forecast.

We are debating whether or not we should delete this tax item from our earnings numbers. We know food companies in similar situations that report 33% tax rates without so much as mentioning the audit in the release. We guess the audit pertains to earnings before fiscal 1992, but shouldn't we then adjust up those numbers if we adjust down fiscal 1992.

All of this is relatively unimportant in predicting fiscal 1993 earnings. We can see by the fourth fiscal quarter release that the apparel business shows no sign of life despite the constant restructuring. Also the international expansion efforts aren't coming cheaply as seen by the 120 basis-point drop in division operating margins.

We are revising our fiscal 1993 (March) projection to $4.35 per share from $4.40 to reflect these apparel and international factors. Also we are disappointed that domestic births in 1991 fell 1.7% to 4.1 million. With a five-month lag in census birth numbers, we are waiting to see if the end of the Desert Storm war in early 1991 and the return home of 0.5 million soldiers will result in a desert stork. Unfortunately, December births were also down 0.2%, but we still expect early 1992 improvement.

We are also moderating our fiscal 1994 estimate from $5.00 per share to $4.90. We are maintaining our 12% five-year compound annual growth rate.

We would buy the stock at current levels despite the reduction in estimates. Valuation using estimated calendar 1992 numbers is highly attractive both to its peer group (10% discount) and to the S&P Industrials (25% discount).

Volume growth in baby food was up 8% in the March quarter and 4% for the fiscal year. (See Table 22.) While these numbers include international markets where margins are lower, few food companies are generating 4% volume growth. Moreover, domestic market share is up almost 200 basis points to over 72%. This near monopoly position deserves better investor recognition.

Management hosted an analysts' meeting in New York on May 15, 1992. Chairman Al Piergallini talked about the company plan to grow annual earnings between 12% and 15% in the next few years. By our inflation assumptions, this nominal growth target is above the company's stated real growth goal of between 6% to 8%. This indicates to us that management believes it can exceed its long-term targets in the near term.

2031660316

Source: https://www.industrydocuments.ucsf.edu/docs/psdl0000